



PETER BOBBIN

LEGAL BRIEF

Ineffective principles

The Financial Planning Association's conflict-of-interest principles are unlikely to prevent another Westpoint fiasco from happening, Peter Bobbin writes.

It is ironic that the Financial Planning Association announced its principles for managing conflicts of interest in the midst of the Westpoint corporate investor collapse. The irony lies not in the timing of release but in the fact that even if it had existed, it would not have helped.

There is also a sense of irony in the level of Westpoint blame being heaped on the industry; Westpoint-scarred investors introduced by unlicensed advisers do not have access to the complaints and compensation systems that are a part of every Australian Financial Services Licensee. The only investors who have a real chance of getting their retirement plans restored will be those who dealt with the most Westpoint-derided professional of today – an AFSL representative, otherwise known as a financial planner.

Already there is talk of increased professional indemnity insurance premiums to pay for the investors who dealt with recognised financial planners. Those who did not may have nowhere

to turn and, in yet another irony, those promoters will not suffer a change in premium costs, not when they were unlikely to be paying them in the first place.

As perverse as it may seem, for the sake of the investors involved, we all should celebrate the fact that they were advised by recognised financial planners.

I have to admit to being troubled by the Westpoint fiasco; my sympathies are split and I feel guilty for this. I feel sorry for investors caught up in the debacle but I cannot help wonder: what blame should they share?

I also recognise that the Westpoint collapse is the corporate disaster that will mark the first decade of our new century. There is a major financial disaster every decade. In the late 1980s, it was the Estate Mortgage collapse; in 1998, \$140 million involving the Wattle Group went down the drain.

This is not intended to be dismissive. Real mums and dads have been affected. Some face financial ruin. But what responsibility should they accept?

“If it is too good to be true, it probably isn’t!” is a commonsense adage that stiffens the backbone of many a sceptical Aussie. Westpoint promissory notes were offering 12 per cent return on cash. Banks were offering 7 to 8 per cent loans provided the security was acceptable to them. Doesn’t this alone suggest that there was something different or perhaps wrong about the Westpoint offering?

What can be done to stop the next Westpoint? Nothing – there will be another in the next decade. Not only is there always the fringe player who is all too ready to dupe the investor, whether or not they started out that way, there will always be the dupee-investor who is only too keen to part with their money for the “too good to be true investment”. The Australian Securities and Investments Commission proved this in 1999 with its Millennium Bug Insurance offer.

ASIC’s 1999 fake internet investment site “convinced” 233 people to part with \$10,000 and \$50,000 with an offer to triple their money in 15 months. What ASIC chairman Alan Cameron said at the time could also apply to today’s Westpoint fiasco: “The first and best protection remains people being sceptical about offers which look too good to be true. They usually are.”

Before I get accused of industry bias, let me make my point clear. ASIC (and the FPA) spend considerable resources in alerting investors to remain sceptical. I do not believe that they could have done any more. And even if they did, I am confident that there are many who simply will not listen. They will pin their dreams on something that sounds too good to be true, and will seek to blame anyone else when it isn’t. Westpoint will happen again.

So please, let’s not see the introduction of the politically infused



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Westpoint amendments; the legislative plugs to the gaping holes that are claimed to exist after the disaster befalls us.

I am not suggesting that we cannot learn from this disaster, but we should wait to see how the system responds. Westpoint is its first significant test. There are likely to be conflict-of-interest issues as well as questions about competency and the appropriateness of advice. And those Westpoint investors that dealt through a financial planner will have the chance of putting their argument – so the first part of the system is working!

When the Westpoint scars are displayed, the most common argument that a client will claim is their own naivety; that it was their own lack of experience that brought them to the financial planner, who breached a duty of care owed to them.

This was the argument that satisfied Justice Philip Mandie in the *Newman & Ors v Financial Wisdom* case. Speaking of one of the claimants, Justice Mandie said: “With all due respect to Mr Duncan, his willingness to engage an organisation which was prepared to put forward these preposterous propositions is indicative of Mr Duncan’s gullibility and naivety (in addition to his desperation) and demonstrates the need which he must have had at all times for professional financial and investment advice.”

The reasonable starting point for any analysis of the role of the financial planner will be that the client was seeking the professional advice of the planner in an area that the client felt they did not have the requisite skills. The naivety argument is a good one. The only defence available is that the adviser did all that was reasonable in the circumstances.

I have ranked the Westpoint-connected Statements of Advice that I have been called upon to examine on a scale of one to seven. At the extreme end the financial plan, if it can be called that, deserves a ranking of one; it is tantamount to gross negligence if not fraud. At the other end is my ranking of seven. Sad though it may be for the client, a seven-ranked financial plan will act as a clear shield against any claim of negligence or incompetence. Indeed, a client who had the benefit of a seven-ranked financial plan would be unlikely to have even rustled the pages of a lawyer’s writ because the client was aware of the risks, understood the concerns and would have made a personal and active decision to embrace these. In other words, the adviser properly advised and the client properly understood.

I have yet to see a one or a seven Westpoint-affected financial plan from an AFSL representative.

You can find the attributes of a seven in the judgement of Justice Mandie. Of course, everything that he found not to exist is what is required for the highly defensible seven-ranked financial plan.

Compliance officers take note; from the fires of Westpoint

should arise your risk management efforts. I have ranked a number of Westpoint-connected financial plans, mostly for advisers but also for some investors. All of these have been regulatory compliant – they would have passed the tick-box approach of a compliance review. This, more than any other point should bear the truth; compliance is about getting and keeping the financial services licence, risk management is about managing the risk of the client and the business.

Aren’t principles merely guidelines? Of course they are. But don’t fall into the trap of believing they will not have any effect on the standard of care that must be applied to the financial planning process

This leads me to why the FPA conflict of interest principles would not have helped.

(But before that, I am actually excited by the release of the FPA principles, at last the industry is driving the business of financial planning in Australia, not the corporate regulator.)

Aren’t principles merely guidelines? Of course they are. But don’t fall into the trap of believing that they will not have any effect on the standard of care that must be applied to the financial planning process. Courts recognise that a statement of principle is not necessarily legally binding, however, when expressed by a defendant’s association, the courts will embrace those principles when judging their standard of care conduct.

I doubt that Principle 1, “disclose the cost of advice separately”, or Principle 4, “the interests of clients to be considered independently of wider group interests”, would have had any impact on Westpoint-scarred clients. Certainly, Principle 3, “remuneration or benefits paid by a FPA principal member”, simply had no application. This leaves Principle 2, “FPA members will undertake the due diligence necessary to offer products which suit the needs of the client”.

This is not new. But it is worthwhile to have it stated clearly. Justice Mandie expressed this view in 2003 when commenting on advice given up to a decade earlier. He accepted the “McMaster method of financial planning”. This included that investment advisers should carry out research and analyse investment products or use research and analysis generated from external sources. There were a range of other elements to the McMaster method of financial planning that compliance officers would do well to study.

On Westpoint, there will be winners and losers, and those that will learn from it. Unfortunately, not everyone will. Asset